25X1

CIA/OER/IM 72-163 Doc/SER

Confidential

DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Netherlands' Economy at Election Time

Confidential

ER IM 72-163
November 1972

Copy No. 79

25X1

Approved For Release 2006/04/19 : CIA-RDP85T00875R001700040046-6

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
November 1972

INTELLIGENCE MEMORANDUM

THE NETHERLANDS' ECONOMY AT ELECTION TIME

Summary

1. Sizable unemployment and record inflation provide the background and proximate cause of the 29 November parliamentary elections called nearly three years ahead of schedule. The governing center-right coalition, formed after the April 1971 parliamentary elections, broke up in July of this year in disagreement over appropriate anti-inflationary measures. With the economy now showing signs of recovery from its recent slump, the danger increases that excess demand will reinforce the cost-push factors currently feeding the wage-price spiral. The caretaker government's modified price controls, announced only a week before the election, may provide temporary relief, but no broad anti-inflationary program can be expected until a new government is formed. This may take some time if the election results are as inconclusive as is generally predicted.

2. Whatever new coalition is formed, it will concentrate on relieving unemployment and inflation as its most urgent domestic economic priority. In foreign economic policy, it will continue recent trends toward an increasing identification with European rather than Atlantic interests. Because of the Netherlands' dependence on foreign markets, the new government will continue to advocate liberal trade policies in European Community councils and generally support US trade and monetary initiatives, but such support increasingly will be tempered by a desire to achieve Community solidarity.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

Discussion

3. The economic upswing during 1968-70 resulted from a strong expansion in overall demand, particularly export demand. Soon the strain on resources became excessive, the trade deficit widened substantially, and unemployment became negligible.[1] Inflation became a major headache by 1969 with an alarming 7.5% rise in consumer prices – the sharpest increase since 1951.

1971: Economic Slowdown, Persistent Inflation

4. Attempting to cool off the economy, the government instituted wage-price controls, tax increases, and restrictions on consumer credit and on industrial construction in selected areas. Reflecting the gradual impact of these measures, real gross national product (GNP) in 1971 grew only 3.9%, the smallest gain since 1966. Industrial production rose only 6.8%, down from 10.0% in 1970, and the increase in private consumption, at 3.5%, was less than half that in 1970. Fixed industrial investment declined 3.5% in 1971 (a sharp reversal from the 17.0% increase in 1970), reflecting pessimistic business expectations, restrictions on new industrial construction, and continued profit erosion. The economic slowdown in the other West European countries, the Netherlands' most important market, also contributed to the end of the boom. Exports grew little more than 10% in 1971, down from 15% in 1970. The deterioration in the trade balance was reversed, however, as imports rose only 7% in 1971 (15% in 1970), causing the trade deficit to decline to US $1.2 billion (from $1.6 billion in 1970).

5. Weakening demand eased the labor market. Registered unemployment nearly doubled during 1971, to 108,000, while job vacancies declined steadily from 117,000 to 65,000. By mid-1972, unemployment reached 2.8% of the labor force.

6. Despite the slowdown, the rate of inflation reached the highest level since the Korean War. The consumer price index rose 7.6% in 1971, up sharply from the 4.4% rise in 1970. This increase reflected in part the intensifying worldwide inflation, against which the small and open Dutch economy could not readily protect itself. A rise in labor costs was also a contributing factor. Wage increases accelerated while productivity gains
25X1 slowed. Business also took advantage of the growing inflation mentality

by raising prices not only to cover increased costs but also to restore previously eroded profit margins.

7. Inflation was a major issue in the April 1971 parliamentary election, but disagreement over specific anti-inflationary measures delayed the formation of a new coalition government for two months and sowed the seeds for its subsequent premature breakup. Despite strong opposition from within the coalition, particularly from the conservative Democratic Socialists, the new government abolished strict wage and price controls in favor of voluntary restraints by labor and management. But voluntary restraints did not work. With management anxious to bolster eroding profit margins and unions making increasingly strident wage demands, the government found it politically impossible to halt the inflationary spiral. Although higher taxes imposed in 1971 restricted private spending, the increase in public expenditures – swollen primarily by government wage and salary increases – tended to offset this reduction. The Central Bank attempted to impose a tight monetary policy by raising minimum reserve requirements and maintaining a high discount rate. But massive inflows of capital generated by the international monetary crisis virtually negated the effect of these measures.

1972: Economic Recovery, Political Breakdown

8. Most observers heralded the second quarter of 1972 as marking the end of the slowdown. The unusually mild winter and early spring generated an unseasonally high rate of business activity that dissipated fears of a major recession in Europe. During the first half of 1972, Dutch industrial production was up almost 8% over the corresponding period of 1971, and exports were nearly 13% higher. Reflecting rising business confidence, investment for the entire year is now expected to decline 4%, against an earlier forecast decline of 6%. Exports benefited from faster growth in principal foreign markets, while imports continued to lag because of the domestic investment slump. Consequently the trade deficit (f.o.b./c.i.f.) for the first half of 1972 – \$302 million – was down two-thirds from the comparable period of the year before.

9. But unemployment and inflation intensified during the first half of 1972. The 2.8% unemployment rate for July was the highest since the early postwar period and nearly twice as high as a year before. Yet wages were 11.8% above the July 1971 level. Consumer prices were 7.3% higher than in July 1971, substantially exceeding the increases in the other Community countries.

10. Initially politically expedient, the government's "hands off" policy on prices and wages came under increasing attack in 1972,

particularly by the Democratic Socialists. In July, disagreements over anti-inflationary tax increases and spending cuts proposed in the 1973 budget precipitated a government crisis. The two Democratic Socialist ministers, Willem Drees, Jr., the public transport minister, and M.L. de Brauw, the science and education minister, resigned from the cabinet in protest against cuts in their budgets, causing the immediate collapse of the government. A caretaker minority government, headed by Biesheuvel and including the old coalition parties, except the Democratic Socialists, took charge until the November elections.

11. Concerned about rapidly climbing public expenditures and fearing that a new economic upswing would further fuel inflation, the interim government proposed a moderately austere budget featuring cutbacks in social welfare spending and some increases in wage and income taxes, value added and corporation taxes, and the excise tax on private automobiles. Despite these measures, the budget deficit would increase from $740 million in 1972 to $923 million in 1973 because of rising costs in already scheduled programs and an overall increase in expenditures.

12. Lacking a parliamentary majority and recognizing its limited lifespan, the caretaker government has not proposed any fundamental reforms to fight inflation. Instead, it urged Parliament to negotiate a voluntary labor-management accord establishing wage-price guidelines for 1973. Tentative agreement on such an accord was reached by the end of October, permitting a 12% rise in wage rates and a 6% rise in prices. The accord would also rescind the previously scheduled increase in the value-added tax on luxury goods and restore some proposed cuts in social benefits. Although aware of its inflationary potential, the interim government reluctantly accepted the plan as the best obtainable under the circumstances. Nevertheless, under increasing opposition attack for its failure to take a positive anti-inflation stand, the government, one week before the elections, imposed modified price controls, stipulating the production cost increases that may be passed on in the form of higher prices.

The Near-Term Outlook

13. Economic recovery should accelerate in the coming months, aided in part by more rapid economic growth in West Germany, which takes one-third of Dutch exports. Because of the upward trend in both industrial production and foreign demand and an upward revision of industry's investment plans, the government upped its forecast for real GNP growth in 1972 from 2% to 3%. The external position of the economy should remain strong, at least in the near term. With the trade deficit virtually eliminated during the third quarter of 1972, the current account now is expected to show a healthy $600 million surplus for the year – a vast

improvement over the $160 million deficit in 1971. This improvement, however, reflects lagging imports rather than booming exports, and import growth will accelerate when the economic upswing gathers speed, probably by next spring. To maintain the favorable payments trends and provide the necessary stimulus for the economy, exports will have to increase more rapidly. Despite unprecedented domestic inflation, the Netherlands' international competitive position has not as yet deteriorated significantly, primarily because prices in the principal partner countries have also risen but also because substantial productivity gains permitted exporters to moderate price increases.(2) As the economy again approaches full employment, however, industry's competitive position will increasingly depend on the government's success in reducing the rate of inflation below that in the major trading countries.

14. But prospects for early easing of inflationary pressures are dim. Consumer prices in October were up more than 8% over a year ago and wages more than 12%. The newly announced modified price controls may offer temporary relief but are not likely to have any longer-run moderating effect. Recent experience with incomes policy in the Netherlands offers little hope for the success of the new labor-management accord on wages and prices for 1973. Militantly insisting on improvements in real wages, the unions will modify their wage demands only if the government maintains strict controls over prices and provides for such social needs as better housing and education. Management, on the other hand, has stated that one condition for its cooperation is reduced government spending – a demand virtually impossible to fulfill. Finally, and perhaps most importantly, the Netherlands cannot isolate itself from inflationary trends in surrounding countries. Dutch anti-inflationary measures can succeed only if taken in concert with similar measures in the other members of the European Community. The outlook for effective Community action is not promising.

15. Unemployment also remains troublesome and could lead to serious social complications. While economic activity has picked up, employers thus far have not begun to hire more labor. The rate of unemployment in October still hovered around the record 2.8% of the labor force, and there is growing concern that labor-saving machinery, installed to offset sharply rising wage rates, will permit a substantial increase in output without a significant increase in jobs. Nearly 120,000 Netherlanders are out of work – and approximately the same number of foreign workers, primarily Turks, Yugoslavs, Spaniards, and North Africans, are employed.

2. The 11.57% revaluation of the guilder relative to the US dollar following the Smithsonian agreement of December 1971 has had no significant impact on the Dutch competitive position, because of similar revaluations by the principal competitors. Less than 5% of Dutch exports go to the United States.

While most of these foreign workers hold menial positions not wanted by the native Dutch, growing labor unrest contributed to the rising racial tensions that culminated recently in a week of violence and bloodshed between native Rotterdamers and Turkish workers.

16. The 29 November elections will be a severe test for the minority four-party Biesheuvel government coalition. On the one hand, its chances have been enhanced by the conclusion of the labor-management accord for 1973 and, more recently, by the imposition of modified price controls. But both actions involve a calculated risk for Biesheuvel. The accord is more inflationary than he had wished, and his last minute resort to price controls smacks of opportunism. The government obviously hopes that the short-run political dividends will outweigh the longer-run economic costs -- but this fact may not be lost on the electorate.

17. Formation of a new government will not be easy, although recent statements by the Democratic Socialists suggest their willingness to restore the five-party coalition formed after the 1971 elections. There is little assurance, however, that a refurbished coalition would be any more stable than the previous one. Anti-inflationary programs and proposals will be the crucial issues in inter-party negotiations. The debate will be between the proponents of vigorously enforced price and wage controls and those favoring some combination of higher taxes and lower government spending. Should the coalition-forming process turn out to be lengthy, as is generally predicted, thus delaying restrictive measures, inflation would accelerate, increasing pressures for new price and wage controls.

Prospects for US-Dutch Economic Relations

18. Of more immediate importance to US policy, any new government, including one based on the present right-of-center coalition, can be expected to continue the shift from an Atlantic to a European orientation. Because of their extensive dependence on foreign trade, the Dutch will remain in the liberal wing of the European Community, exerting a moderating influence on the more protectionist-minded members and generally supporting US trade initiatives. But this support will be increasingly tempered by a desire to achieve European solidarity. In the upcoming negotiations, the Netherlands will join West Germany, the United Kingdom, and Denmark in trying to persuade France to be more accommodating toward the United States, but the Hague will neither lead the opposition nor break with Paris over specific issues.